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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 012763

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SUBJECT: CPC UPDATE: FURTHER MOVEMENT TOWARD FINISH LINE?

REF: MOSCOW 12587

Classified By: Econ M/C Quanrud. Reasons 1.4 (b/d).

¶1. (C) SUMMARY. On December 1, Ian MacDonald, head of Chevron Russia and former head of CPC told us that the hoped-for "seniors'" meeting -- at which a CPC expansion MOU may have been signed -- did not come off this week. However, CPC shareholders held a highly positive meeting which cleared away several lingering issues, including approving funding to fix a deteriorating stretch of the pipeline and reaching agreement on a budget for the first quarter of next year. However, as expected (reftel), the GOR insisted on a transit tariff of USD 38/ton. MacDonald views this stance as firm and expects the Kazakhstanis to agree to it but predicted ExxonMobil would resist. On other issues, he said that the GOR deferred the tax case against CPC until December 25 and Chevron will soon inform interested parties of its official negotiating stance on the construction of the Burgas-Alexandroupolis pipeline (BAP). END SUMMARY.

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SHAREHOLDERS' MEETING BREAKTHROUGHS

¶2. (C) MacDonald told us the shareholders met on November 28-29 and agreed on a number of long-outstanding items. First, they approved funds and the contract for the purchase of pipe for the rehabilitation/replacement of a 116-kilometer stretch of pipeline in Kazakhstan. Without this approval, MacDonald said CPC would have been forced to reduce the entire pipeline's throughput, which would have thrown CPC's finances into a tailspin. Second, shareholders approved a USD 150 million operating budget. Although only for the first quarter and slightly less than Chevron had proposed, approval of the budget means another mini-crisis in the near term avoided. Third, they approved the 2005 financial statement, which Russian reps had been holding up under what some suspected were reasons linked to the tax suits against CPC (see below).

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MOU PROGRESS

¶3. (C) According to Chevron, the GOR and GOK have agreed to do some final editing of the MOU in the very near future. The central changes relates to Russia's "firm government position" that CPC's debt must be repaid by 2014. This date appears to be immutable in the Russians' mind, and it appears Kazakhstan will agree to it. As reported reftel, this would

precipitate a tariff increase to USD 38/ton, the maximum allowed in the founding agreement. Given the fact that the bulk of the higher transportation costs would be paid by Kazakhstan, MacDonald expects that if the Kazakhstanis agree to pay the higher tariff, then the others will follow suit. He noted that compared with the previous unanimously-agreed tariff, this increase amounted to significantly less than a dollar a barrel, which is acceptable in the current price environment. He opined nonetheless that resistance from ExxonMobil, or at least extra time for them to agree to this latest increase, could be expected.

14. (C) Beyond the tariff level, the last issues being discussed are the size of the board (western firms want 22, the GOR wants 20 or 16, and Lukoil wants 16) and some rules about quorums. Chevron proposed to the GOR, outside the formal meeting, that the GOR accept the westerners' preference for board size in return for shareholders' acceptance of Russia's preferred quorum modalities. A few other very minor technical issues on corporate governance remain, but Chevron notes that while they are not important to Russia they are important to the companies.

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CPC TAX CASE

15. (C) The November 29 court of appeal hearing on the tax claim against CPC was deferred to December 25 because the Russian Property Agency did not appear in court after having been called to court as a witness for the GOR. While many interpretations could be placed on this deferral, Chevron and most others believe it most likely that the GOR did not want the result of the case to influence finalizing the MOU, as the deferral puts additional pressure on the producing

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company-owners to concede to the MOU. Moreover, the MOU will be perceived as evidence that CPC can be profitable, and thus will influence the court's decision in a good way, but nonetheless no one is ruling out a negative court decision.

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PROGRESS ON BAP

16. (C) Separate from the CPC talks and shareholders' meetings, MacDonald informed us that he had a very positive and constructive talk with Sergei Oganessian, head of the Federal Energy Agency, about both CPC and the BAP pipeline. Oganessian appeared not well educated on BAP (whereas, by comparison, Transneft is quite well-versed, according to MacDonald). Oganessian casually remarked that BAP does not need Chevron because it would be built anyway, but by the end of the conversation came to see the need for Caspian oil via CPC to fill BAP. In fact, he agreed fully that KazMunaiGaz should be a partner in BAP along with Chevron, the two companies comprising the "Caspian partners" in BAP. In the end, both agreed that the main problem was that there is not enough equity to go around for the parties interested in participating. MacDonald informed us Chevron is in contact with parties in Greece and Bulgaria and intends this week in a series of meetings in London to decide on its formal approach to all parties. He promised that contacting our embassies in the region would be on their agenda.

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COMMENT

17. (C) As in our previous updates, CPC is not appealing for any particular advocacy or help at this point but wants to keep the USG informed. While this deal will not be over until it is over, progress in the shareholders' meetings, coupled with a positive (even joking) meeting with Oganessian -- long one of the bete noire's of the CPC story -- and the apparent near-finality of the \$38/ton tariff and the 2014 debt retirement date, may mean that we are only mechanical steps away from final approval of expansion.

